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MEMORANDUM FOR THE RECORD

SUBJECT: Iran's Pricing System for Oil, What Would an  
OPEC-Wide Single Price System Mean?

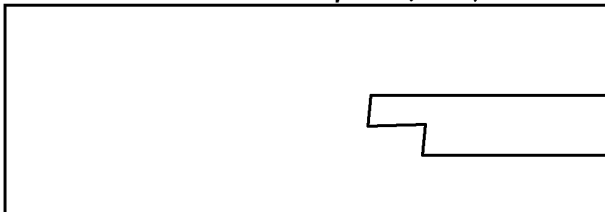
The attached information on the Iranian Oil Pricing System and the Implications of a Single Price for Oil was prepared for Mr. Charles Naas, Country Director for Iran, US Department of State, for inclusion in a briefing book for Secretary Kissinger.



Office of Economic Research

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IRAN'S PRICING SYSTEM FOR OIL

Iran's single price for its oil stems from the fact that all oil produced by the consortium of western international oil companies is owned by the Iranian government. Under the terms of an agreement signed in July 1973, the government sells this oil to the consortium on 20-year contracts. This arrangement is in marked contrast to that used in most of the Persian Gulf oil-producing countries where a certain percentage of the oil produced is owned by the oil companies themselves -- the so-called equity oil -- and the remainder is owned by the host country -- so-called participation oil. Although Iran sells its oil to the consortium at a single price, with minor variations for quality, the Persian Gulf states charge one price for participation oil and levy taxes and royalties that result in another price for equity oil. The companies in these Arab producing states sell the oil based on an average of the two prices.

The price Iran charges the consortium is based on the going price for oil sold by the Persian Gulf producers. With the price paid for Arab oil continuing to increase, the Shah assures that he gets the same revenue per barrel by retroactively billing the companies for the difference between the price paid Iran during the quarter and the price realized by the Arabs during the same quarter.

By having a single price with the retroactive payments, the Shah has the best of all worlds and the consortium at least knows that the oil it buys will be no higher in cost than the average of oil sold by the Arab states. This certainty gives the companies that make up the consortium an incentive to make any necessary production cuts by reducing output of participation oil in Arab countries. It also gives these same companies an incentive to increase output in Iran rather than in the Arab states.

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WHAT WOULD AN OPEC-WIDE SINGLE PRICE SYSTEM MEAN?

An OPEC-wide single price system along the lines suggested by the Shah would:

- Eliminate the posted price,
- Eliminate the equity price,
- Eliminate the participation price,
- Establish a single price for all oil, with variations for quality, transportation differential, etc., and
- Imply nationalization of the oil companies.

Establishing a single price system would not necessarily mean higher or lower prices. Since prices are set politically now, they would presumably be politically set under a single price system. It nonetheless seems likely that the tendency will be to make this single price higher than the average price is now. Several OPEC countries, particularly Algeria, Iraq, and Libya will argue for a single price that would approximate the current posted price. In this case, oil prices would be increased on the order of \$1.00 a barrel.

There are advantages to a single price system for both consumer and producer.

- A single price would eliminate the steady increase in prices that has occurred as a result of the governments' increasing their ownership share of the oil companies.
- A single price system would increase *transparency* – i.e., it would be much easier to determine profit per barrel the oil companies and governments were making.
- A single price presumably would eliminate government oil auctions. Prices received in auctions have been used to claim that prices that companies paid for equity oil were too low.